without prejudice to the prosecution by Petitioner of his pending New York Supreme Court action. (App., p. 90a)

Similarly, the Court of Appeals in affirming the judgments of the District Court stated that it did "not decide that the creditors of Manhattan do not have any remedy under general state tort law for the fraud practiced on their debtor, but only that the federal Securities Acts have not provided a federal forum for its enforcement." (App., p. 107a)

Questions Presented

1. Does a misappropriation of corporate funds which may be traced in part to the proceeds from the sale of corporate securities constitute a fraud in connection with the sale of those securities in violation of the federal securities laws?

2. Can a corporate seller of securities recover under the federal securities laws when its sole stockholder authorizes and approves the allegedly fraudulent sale of its securities?

3. Do creditors of a corporation have standing under the federal securities laws to obtain judicial review of securities transactions of that corporation and decisions of the corporation's management with respect thereto?

Summary Statement of the Case

This summary statement of the case contains the most significant events claimed by Petitioner to describe a violation of the federal securities laws. In the Complaint herein, in his complaint in the New York State action, in his answers to interrogatories and in the many briefs he has filed in this action, Petitioner has depicted

numerous—and occasionally inconsistent—incidents which allegedly caused $5,500,000 damage to Manhattan. This summary statement does not attempt to include all such details, but merely outlines those alleged facts which Petitioner claims support the legal theories on which he now relies. A more complete statement of the facts with citations is set forth as Attachment A to this brief.

The events leading to this action commenced in late 1961 when Begole negotiated with Bankers Life for the acquisition of its wholly-owned subsidiary, Manhattan. Begole contracted to purchase Manhattan on January 24, 1962 for $5,000,000. Financing for Begole's purchase was arranged by Bourne, who enlisted the assistance of Garvin, a partner in Garvin, Bantel.

On January 24, 1962, at the request of Garvin, C. Joseph Gunter ("Gunter"), an Assistant Secretary of Irving, drew a $5,000,000 Irving check payable to Bankers Life. At the closing of the sale of Manhattan, the check was delivered to Bankers Life in payment for Begole's purchase of all of the Manhattan capital stock.

Immediately after acquiring Manhattan, Begole installed a new Board of Directors, including himself as Chairman. The new Board then elected Begole's nominees as officers—including Sweeny as President—and authorized the sale of Manhattan's Treasury bonds and the purchase of a $5,000,000 certificate of deposit from Belgian Trust.

Later on January 24, 1962, Gunter received the Manhattan Treasury bonds which were sold through Garvin, Bantel and delivered to the purchaser, Second District Securities Co., Inc. Fair value in the amount of $4,854,552.67 was paid by the purchaser for the bonds. Gunter credited the $4,854,552.67 to an account of Manhattan at Irving and also credited to that account $150,000 received by check from Manhattan.

Also on January 24, 1962, Gunter, pursuant to instructions from Garvin, drew a $5,000,000 Irving check payable to Belgian Trust and delivered it to Sweeny at the Belgian American Banks. Sweeny deposited the check with Belgian Trust which issued a six month $5,000,000 certificate of deposit to Manhattan. Both Sweeny, as President of Manhattan, and Manhattan's Assistant Treasurer endorsed the certificate of deposit to New England. Sweeny gave the CD to Bourne, President of New England, who in turn endorsed it to Belgian Banking. Thereupon Belgian Banking loaned $5,000,000 to New England and for collateral took possession of the Belgian Trust CD which had been endorsed by Sweeny and Bourne. The proceeds of this loan were paid in the form of a $5,000,000 Belgian Banking check payable to Irving for the account of New England which was delivered to Gunter. At the same time Belgian Banking made another loan to New England of $250,000 which was secured by the outstanding shares of Manhattan which had been assigned by Begole to New England.

On July 24, 1962, Belgian Trust's six month certificate of deposit payable to Manhattan matured and the loans by Belgian Banking to New England became due. At that time certain new arrangements were effectuated. Belgian Trust credited Manhattan's account with $74,383.56 interest on the Manhattan CD, and the principal amount of the CD which had been endorsed on behalf of Manhattan by Sweeny was used to purchase a new six-month $5,000,000 Belgian Trust CD for Manhattan. This new CD was delivered to Sweeny, as President of Manhattan, and kept by him in his possession. Belgian Banking's loans to New England were extended to January 24, 1963.

In August, 1962, Sweeny returned the certificate of deposit he had been holding to Belgian Trust, and Manhattan was issued a negotiable six month $5,000,000 CD, also dated July 24, 1962. Sweeny endorsed this new CD on behalf of

Manhattan and delivered it to Belgian Trust together with instructions to deposit its proceeds upon maturity in Manhattan's account at Belgian Trust. In addition, he delivered a $500,000 CD of the First National Bank of Boston, which was also owned by Manhattan, to Belgian Trust. Both CDs were delivered on the assurance of a letter from Belgian Trust stating that they would be held in trust for Manhattan.

On January 25, 1963, additional transactions occurred which Petitioner claims were part of the conspiracy to defraud Manhattan. Belgian Trust credited Manhattan's account with $5,590,977.62. $5,000,000 of this sum represented principal of the Belgian Trust CD issued to Manhattan in August of 1962; $75,616.44 represented interest on that CD; $500,000 represented principal of the First National Bank of Boston CD which had been delivered to Belgian Trust; and $15,361.18 represented interest on the First National Bank of Boston CD.

Also on January 25, 1963, Belgian Trust issued a $5,500,000 check payable to Irving and charged it against the Manhattan account which had theretofore been credited with $5,590,977.62. Irving, pursuant to instructions from Garvin, issued a $5,250,000 check payable to Belgian Banking. The Belgian Trust check to Irving and Irving's check to Belgian Banking were exchanged on January 25, 1963 at the Belgian American Banks. The Irving check was used by Belgian Banking to repay its $5,250,000 loans to New England. Pursuant to instructions from Garvin, the $5,500,000 Belgian Trust check payable to Irving was credited to the Garvin, Bantel account at Irving and the $5,250,000 Irving check payable to Belgian Banking was debited to the Garvin, Bantel account. The net effect of these alleged transactions was to apply funds in the Manhattan account at Belgian Trust to the repayment of the Belgian Banking loans to New England.

As a consequence of the foregoing transactions, Petitioner suing in Manhattan's behalf alleges that Manhattan was defrauded of $5,500,000 in violation of the federal securities laws. Petitioner has suggested two alternative times at which Manhattan funds may have been misappropriated. Under Petitioner's first theory, Manhattan was injured on January 24, 1962, when $5,000,000 of $5,004,552.67 (consisting of $4,854,552.67 deposit of proceeds of securities plus $150,000 cash deposit) in the Manhattan account at Irving were diverted by Begole to pay for the check to Bankers Life used for the purchase of the Manhattan stock. Under Petitioner's second theory, Manhattan was injured on January 25, 1963, when $5,500,000 of funds in its account at Belgian Trust were misappropriated; $5,250,000 of which was used to repay the Belgian Banking loans to New England and $250,000 of which was diverted by Begole and Sweeny. Under the second theory, the $5,000,000 Irving check to Bankers Life was paid for by the $5,000,000 Belgian Banking check payable to Irving for the account of New England which represented the proceeds of one of the Belgian Banking loans to New England.

ARGUMENT

I.

MISAPPROPRIATION OF CORPORATE FUNDS WHICH MAY BE TRACEABLE IN PART TO THE PROCEEDS FROM A SALE OF CORPORATE SECURITIES DOES NOT CONSTITUTE A FRAUD IN CONNECTION WITH THAT SALE IN VIOLATION OF THE FEDERAL SECURITIES LAWS.

Petitioner claims that Manhattan was defrauded of $5,500,000 as a result of an alleged fraud in connection with the sale of securities in violation of Section 10(b) of the 1934 Act. The alleged fraud consists of a misappropriation of corporate funds which may be traceable in part to a

corporate securities transaction. Upon analysis, however, such a misappropriaion does not constitute a fraud in connection with a securities transaction and was not intended by Congress to constitute such a fraud. To hold otherwise would result in federal preemption of a major part of state corporate law.

A. There is a distinction between a fraud in connection with a security transaction and the effectuation of a security transaction as an incident to the perpetration of a fraud.

This case involves the proper interpretation of the statutory phrase "in connection with the purchase or sale of any security". The Second Circuit recently reaffirmed its interpretation given to that phrase herein by stating:

> "§10(b) liability arises only when the alleged fraud between the parties and/or [the] alleged market manipulation or deception is intrinsic to the securities transaction itself." [Footnotes omitted] *Drachman* v. *Harvey*, Docket No. 35077, CCH Fed. Sec. L. Rep. ¶93, 129 at 91, 100, 91, 101 (2d Cir. July 21, 1971).

Thus, it is not sufficient for a plaintiff merely to allege both a fraud and a security transaction. As Judge Herlands stated in dismissing the Complaint herein:

> "A federal claim is not pleaded by allegations that, in the course of a scheme to loot a corporation of its assets, certain security transactions occurred, when these transactions—though contaminated by the overriding evil intent to accomplish the ultimate looting—did not involve fraud or deceit in connection with the sale or purchase of a security." App., p. 83a.

For a fraud to occur in connection with the purchase or sale of a security, that fraud must materially affect the purity of the security transaction or the purity of the security trading process. The wrongdoing may involve, among

other things, the terms of sale,[2] dishonesty by a broker,[3] manipulation of a market,[4] or failure to provide accurate information to the investing public.[5] But wherever the fraud occurs in the securities exchange process, it must affect a part of that process to be subject to the federal securities laws.

In this case, no injury is alleged to have occurred at any point in the securities exchange process. No participant in any securities market is alleged to have acted dishonestly; no market for any security is alleged to have been manipulated; and no security is alleged to have been sold for other than its fair value. Manhattan's Treasury bonds were delivered by Chemical Bank to Irving; they were sold through Garvin, Bantel to Second District Securities Co., Inc., a leading dealer in the government bond market; and the proceeds of $4,854,552.67 paid by Second District were credited by Irving to Manhattan's account. The alleged wrong was not in the security transaction but rather in the later misappropriation of $5,500,000 of Manhattan's funds, $4,854,552.67 of which may be traceable to the proceeds of sale of the bonds.

Petitioner has suggested two alternative times at which Manhattan funds may have been misappropriated. Under Petitioner's first theory, Manhattan was injured on January 24, 1962, when $5,000,000 of $5,004,552.67 (consisting of $4,854,552.67 deposit of proceeds of securities plus $150,000 cash deposit) in the Manhattan account at Irving were diverted by Begole to pay for the check to Bankers Life used for the purchase of the Manhattan stock. This

2. *Schoenbaum* v. *Firstbrook*, 405 F.2d 200, *rev'd en banc on other grounds*, 405 F.2d 215 (1968), *cert. denied sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 (1969).

3. *SEC* v. *Lawson*, 24 F. Supp. 360 (D. Md. 1938).

4. *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21 (S.D.N.Y. 1963).

5. *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Kline* v. *SEC*, 394 U.S. 976 (1969).

theory has the advantage of simplicity but is inconsistent with Petitioner's second theory and certain facts admitted by Petitioner.

Under Petitioner's second theory, Manhattan was injured on January 25, 1963 when $5,500,000 of funds in its account at Belgian Trust were misappropriated; $5,250,000 of which was used to repay the Belgian Banking loans to New England and $250,000 of which was diverted by Begole and Sweeny. Under this theory, the $5,000,000 Irving check to Bankers Life was paid for by the $5,000,000 Belgian Banking check payable to Irving for the account of New England which represented the proceeds of one of the Belgian Banking loans to New England.

Also under this theory, $5,000,000 of the funds in the Manhattan account at Irving on January 24, 1962 were used by Manhatian to purchase the $5,000,000 Belgian Trust certificate of deposit issued to Manhatan on that date. The proceeds of this certificate of deposit were used on July 24, 1962 to pay for a second six-month $5,000,000 Belgian Trust certificate of deposit. Also on July 24, 1962, Manhattan's account at Belgian Trust was credited with $74,383.56 interest on the maturing certificate of deposit. In August of 1962, the Belgian Trust certificate of deposit which had been issued on July 24, 1962 was exchanged for a new negotiable Belgian Trust certificate of deposit in the same amount in the name of Manhattan, and the new certificate of deposit was delivered to Belgian Trust together with a $500,000 certificate of deposit of the First National Bank of Boston also owned by Manhattan. Both certificates of deposit were delivered on the assurance of a letter from Belgian Trust stating that they would be held in trust for Manhattan and that the proceeds would be credited to Manhattan's account on maturity. Petitioner alleges that the $5,590,977.62 principal and interest of those

two CDs were credited to a Manhattan account at Belgian Trust on January 25, 1963. He further claims that thereafter Manhattan was injured when $5,250,000 of those funds were misappropriated to repay the Belgian Banking loans to New England and $250,000 were diverted by Begole and Sweeny.

Under either theory Petitioner has alleged no more than a complicated scheme of common law fraud in which the diverted funds may be traced in part to a securities transaction. Under his first theory, the proceeds of the Manhattan Treasury bonds may be traced to a misappropriation which allegedly occurred on the same day as their sale. Under his second theory, the proceeds of the bonds may be traced to the purchase of the Belgian Trust CDs whose proceeds were eventually misappropriated. However, neither effort to trace the proceeds of Manhattan's Treasury bonds describes a fraud in connection with their sale within the meaning of the federal securities acts. The possibility that Petitioner may trace some of the converted funds to the bond proceeds does not taint the non-fraudulent sale of the bonds and cause that sale to have been "in connection with" the subsequent misappropriation within the meaning of Section 10(b).

The essence of the fraud in this case is a conversion of corporate assets. (App., pp. 84a, 89a) No fraud occurred in connection with the sale of the bonds, and thus no fraud occurred in violation of the federal securities laws.

The critical issue presented here is whether there is a limit to the concept of a fraud in connection with the purchase or sale of a security or whether any relationship—however indirect, attenuated or tangential—is sufficient to establish federal jurisdiction. Both the Congressional intent underlying the enactment of the 1934 Act and the extensive preemption of traditional state law which would result from a contrary holding compel the conclusion that

there is a jurisdictional distinction between Section 10(b) claims and non-federal anti-fraud claims. This distinction, as stated by Judge Herlands below, is that: ". . . . Rule 10(b)-5 requires the employment of fraud in connection with a security transaction, which is essentially different from the effectuation of a security transaction in connection with a fraudulent activity." (App., p. 84a)

B. Congress did not intend to regulate conduct which does not in any way affect investment decisions or the public interest in maintaining sound securities markets.

Although Section 10(b) is perhaps the most litigated provision of the federal securities laws, its draftsmen seem not to have anticipated its potential significance. It "was one of the least controversial parts of the 1934 Act", and there is a "dearth of evidence" as to the Congressional intent in enacting it. Bromberg, *Securities Law: Fraud—SEC Rule 10b-5,* Sec. 2.2. As a consequence, one can only deduce the legislative purposes for its enactment from the more abundant information available about other sections of the statute.

From the background of the 1934 Act generally and in view of the economic events which provoked its adoption, it appears that "the anti-fraud provisions were adopted to protect the trading process in the securities markets [footnote omitted], not to provide a federal remedy for every injury that might in any way be connected with a securities fraud." Boone and McGowan, "Standing to Sue under SEC Rule 10b-5," 49 Tex. L. Rev. 617, 622 (1971). As the Court of Appeals for the Second Circuit recognized:

> "The dominant Congressional purposes underlying the Securities Exchange Act of 1934 were to promote free and open public securities markets and to protect the investing public from suffering inequities in

trading. . . ." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 858 (1968), *cert. denied*, 394 U.S. 976 (1969).

More specifically, the Fifth Circuit recently concluded that:

> "By section 10(b) Congress meant to prevent manipulation and control of the prices at which securities are bought and sold and to enable buyers, sellers, and traders of securities to make a proper appraisal of the value of securities." *Herpich* v. *Wallace*, 430 F.2d 792, 801 (5th Cir. 1970).

Notwithstanding the paucity of information as to Congressional intent in enacting Section 10(b), both Petitioner and the Securities and Exchange Commission ("SEC"), as *amicus*, have contended that legislative history sanctions an action such as this. A complete examination of the sources of legislative history cited by Petitioner and the SEC indicates that those sources do not support the proposition that conduct such as that alleged herein should constitute a fraud in connection with a securities transaction.

The overriding purpose of Congress in enacting the 1934 Act was the regulation of issuers, exchanges, brokers and speculators in order to protect participants in investment transactions and to prevent the recurrence of an economic depression. As the Court of Appeals indicated below:

> "Although in the broadest sense the public interest is involved when a corporation which is subject to regulation by the state Superintendent of Insurance is defrauded, the public interest cognizable by §10(b) is limited to preserving the integrity of the securities markets." App., p. 107a.

Congress did not intend to protect investors in all of their business transactions, but rather to provide a federal

remedy for them when they engage in a purchase or sale of securities. Congress intended to reduce the risks of dealing in securities, but did not attempt to guard against the risks of accumulating cash or owning bank accounts as a consequence of dealing in securities. Investors are afforded certain protection by Section 10(b) when they function as investors, but are not afforded this protection when they are not functioning as investors.

The consequences of this distinction are made clear in a case such as this in which the "person" dealing in securities is not an individual but rather a corporation which must act through agents who may have interests contrary to its own. When an individual purchases or sells securities, the federal courts look only to the integrity of the transaction in which he participates and to the market mechanisms and institutions by means of which the transaction occurs. Presumably, the federal interest is no broader in the case of corporations. When the individual investor disposes of a security, the federal courts do not inquire as to the use of the proceeds. Presumably, there is no greater need for federal review of the use of security proceeds by corporate investors.

Although corporate insiders have opportunities to divert for their own benefit the proceeds of corporate securities transactions, those opportunities are no greater than, and no different from, the opportunities afforded those persons to misuse other corporate assets. The mere fact that an embezzlement or misappropriation of corporate funds can be linked by some chain to a securities transaction does not change the character of that wrongful act from an embezzlement or misappropriation to a federal fraud. The Congressional purpose underlying the Securities Exchange Act was to protect the corporate investor when it functioned as such—that is, when it availed itself of brokers, exchanges, credit agencies or other instrumentalities of the

securities markets. The corporate assets resulting from such participation were not the subject of federal regulation.

C. To find a federal wrong herein would result in federal preemption of state law governing corporate mismanagement.

The alleged wrong in this action was the misappropriation of Manhattan's funds. Misappropriation of corporate assets has long been held under state law to constitute corporate waste, and state remedies are available against officers, directors and shareholders guilty of such a breach of fiduciary duty. In this case the Court must decide whether state law relating to corporate mismanagement will be preempted by judicially created federal law. If the Court decides to preempt state law and to create a federal corporate law, a substantial increase in federal court litigation will result.

The lower federal courts have concluded that such federal preemption is not warranted by either the language or the legislative history of the 1934 Act. See *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Lester* v. *Preco Industries, Inc.*, CCH Fed. Sec. L. Rep. ¶91,562 (S.D.N.Y. 1965); and *Kaminsky* v. *Abrams*, 281 F.Supp. 501 (S.D.N.Y. 1968). As the court observed in *Barnett* v. *Anaconda Co.*, 238 F.Supp. 766, 770 (S.D.N.Y. 1965), in dismissing a complaint brought under both Section 10(b) and Section 17(a), the federal securities acts have not "swallowed the whole body of state statutory and common law covering the internal administration of the affairs of corporations and the fiduciary obligations of those who manage and control them."

Absent clear legislative intent, such preemption of state law and such increased burden upon the federal courts should not be sanctioned. The 1934 Act was not intended to supersede state law,[6] but rather to make avail-

6. State law was then, and is now, effectively coping with new types of corporate mismanagement. See, *e.g.*, *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

able new remedies applicable to transactions in the interstate securities market. As Professor Loss has pointed out:

> "the implication of a private action under Rule 10b-5 has already displaced and federalized a great deal of state law, not only in the area of deceit but also with respect to the duties of officers and directors to the corporation and its stockholders. A District Court has recently observed in another context that, 'where effective state remedies for the conduct proscribed by the federal statute are available throughout the country, there is generally little reason to imply a federal cause of action.' Olympic Capital Corp. *v.* Newman, 276 F.Supp. 646, 657 (C.D. Cal. 1967). The very lengths to which the 10b-5 development has been carried inevitably arouse some doubt whether so marked a reform in important areas of essentially 'private' law, however, overdue it may have been, can be justified on the basis of an eight-line omnibus provision in a securities statute that gives the enforcing agency a rule-making authority to deal with types of market "shenanigans" that the draftsmen might not have dealt with specifically." 6 Loss, *Securities Regulation* 3870 (1969 Supp.)

In the context of both effective state regulation and the Congressional intent, expansion of Section 10(b) by judicial interpretation to include the misappropriation of corporate funds by corporate insiders is not justified. Such a broad expansion of the statute should be left to Congress. As the Fifth Circuit recently stated:

> "If Congress had intended that the federal courts inquire into every decision affecting the management of corporations and then fashion a new federal law superseding state law on the fiduciary responsibilities of corporate directors, officers, and controlling persons, presumably so revolutionary a federal intervention into an area traditionally handled by the states would have been clearly expressed." *Herpich* v. *Wallace,* 430 F.2d 792, 809 (5th Cir., 1970).

II.

PETITIONER CANNOT RECOVER ON BEHALF OF MANHATTAN UNDER THE FEDERAL SECURITIES LAWS BECAUSE MANHATTAN'S SOLE SHAREHOLDER AUTHORIZED AND APPROVED THE SALE OF ITS SECURITIES.

Petitioner alleges that he is suing as Liquidator of Manhattan and that as Liquidator he is vested with all rights of action of Manhattan. (Complaint ¶2; App., p. 4a; Petitioner's Brief p. 5) However, Petitioner cannot state a claim under the federal securities laws on behalf of Manhattan because Manhattan's sole security holder, defendant Begole, authorized and approved all actions taken by Manhattan relating to the purchase or sale of securities.

A corporation which sells securities cannot be injured, in its capacity as a seller, when its sole shareholder authorizes, and is aware of all circumstances surrounding, the sale transaction. All of the shareholders of a corporation constitute the corporation and consequently cannot defraud themselves by any corporate action which is ratified by them. See *Cunningham* v. *Jaffe,* 251 F. Supp. 143 (D.S.C. 1966). In *Schoenbaum* v. *Firstbrook,* 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Manley* v. *Schoenbaum,* 395 U.S. 906 (1969), where a corporation was alleged to have issued stock to its controlling shareholder for an inadequate consideration, the Court of Appeals for the Second Circuit recognized that a Section 10(b) action could be brought on behalf of the corporation only because minority shareholders of the issuer had been deceived in connection with that sale. See 405 F.2d at 220; see also the opinion of Hays, J., dissenting to the decision of the panel in that case, at 405 F.2d 200, 215.

As the court held in *Field* v. *Lew,* 184 F. Supp. 23, 27 (E.D.N.Y. 1960), *aff'd* 296 F.2d 109 (2d Cir. 1961), *cert. denied, Field* v. *Bankers Trust Co.,* 369 U.S. 859 (1962):

> "A corporate officer who uses corporate funds for his own purposes may be liable for conversion to the

corporation and in bankruptcy to the trustee. Since the officer had no title to the property, transferees of the officer may be similarly liable. However, the general rule of liability does not apply when the officer's acts have been ratified by all the shareholders of the corporation. In that case, the unauthorized acts of the individual become the authorized acts of the corporation, the corporation loses its right of action against the officer, and the corporation, having no right, the trustee in bankruptcy also has no right. See Reif v. Equitable Life Assurance Soc'y, 1935, 268 N.Y. 269, 197 N.E. 278, 100 A.L.R. 55; Barr & Creelman Mill & Plumbing Supply Co. v. Zeller (sic), 2 Cir., 1940, 109 F.2d 924; Quintal v. Kellner, 1934, 264 N.Y. 32, 189 N.E. 770; Rosenfeld v. Fairchild Engine & Aviation (sic) Corp., 1955, 309 N.Y. 168, 180, 128 N.E.2d 291, 51 A.L.R.2d 860 (dissenting opinion); Capitol Wine & Spirit Corp. v. Pokrass, 1st Dept. 1950, 227 (sic) App. Div. 184, 98 N.Y.S. 2d 291; John William Bldg. Corp. v. Union Trust Co., 4th Dep't 1939, 256 App. Div. 885, 9 N.Y.S.2d 14; New York Credit Men's Adjustment Bureau, Inc. v. Manhattan Life Ins. Co., City Ct. N.Y. 1955, 149 N.Y.S.2d 778. Under the facts of the instant case, the corporation would have no action in conversion against Lew, any of his transferees, or any one participating in the transfer, because Lew as sole stockholder ratified his own actions."

As the *Field* case illustrates, it is important to distinguish the various capacities in which a corporate trustee or liquidating agent may act. Each capacity may provide the agent with standing to assert different causes of action, but, of course, each separate cause of action will be subject to its own defenses. The agent may bring a suit in the right of the corporation, but will be subject to the defenses and counterclaims to which the corporation would be subject. On the other hand, the agent may have the right to litigate on behalf of the creditors of the corporation as distinguished from the company itself. See, *e.g.*,

Bankruptcy Act §70e, 11 U.S.C. §110(e). In that situation, the agent would be free of defenses against the corporation but might be subject to other objections not applicable to the corporation.

In the present case, Petitioner asserts that he is litigating on behalf of Manhattan, the corporation. In that capacity he is subject to the defenses to which Manhattan would be subject. In particular, he cannot claim that Manhattan was a defrauded seller when the sole shareholder of the corporation was aware of, and in fact the planner of, the sale transaction. See *Field* v. *Lew, supra,* and 13 Fletcher, *Corporations* §§5862 and 5866 (1970 ed.).

This is not to say that the conduct of a sole shareholder in diverting to his personal use corporate funds which were generated by the sale of securities violates no law. Such conduct may constitute the payment of an illegal dividend or may violate state laws respecting creditors' rights. See opinion of Judge Herlands below, App., p. 84a; see also New York Debtor and Creditor Law §§270-281 and New York Business Corporation Law §§719, 720. But the mere fact that such conduct may otherwise be unlawful does not mean that it violates the federal securities laws. See *Iroquois Industries, Inc.* v. *Syracuse China Corporation,* 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied,* 399 U.S. 909 (1970), and *Carliner* v. *Fair Lanes, Inc.,* 244 F. Supp. 25 (D. Md. 1965). Those statutes are intended to protect persons who engage in securities transactions. When the sole shareholder of a corporation authorizes the transaction in question, no federal injury can occur to the corporate "person".

A recent decision of the Court of Appeals for the Fifth Circuit, *Bailes* v. *Colonial Press, Inc.,* Docket No. 29048, CCH Fed. Sec. L. Rep. ¶93,085 (5th Cir. June 15, 1971), may be in conflict with the reasoning set forth above. In that case the court held that a federal trustee in bankruptcy stated a claim on behalf of a corporation against

corporate promoters under Section 10(b) of the Securities Exchange Act of 1934, even though at the time of the alleged fraud all of the shareholders, *i.e.*, the promoters, had approved of and participated in the corporate transaction. The court conceded that it was acting without any direct precedent and stated that if was reversing a "well-reasoned" opinion of Judge Allgood that no claim could be stated under the 1934 Act. (The opinion of Judge Allgood appears as an appendix to the *Bailes* decision at CCH Fed. Sec. L. Rep. ¶93,085 at 90,989.) As the *Bailes* case involved the liability of promoters of a newly organized corporation, it is also in direct conflict with the holding of this Court in *Old Dominion Mining and Smelting Co.* v. *Lewisohn,* 210 U. S. 206 (1908). In *Old Dominion,* the Court held that under federal common law a corporation has no cause of action against its promoters for an injury incurred in connection with the sale of its stock to the promoters when all of the shareholders participate in and ratify such sale. In short, there is no precedent for the *Bailes* decision under the federal securities laws and it would appear to be in conflict with *Old Dominion* insofar as federal common law is concerned.[7]

The error of the decision in *Bailes* that a corporate seller may recover notwithstanding ratification of the sale transaction by all shareholders is that it misinterprets the pur-

7. The *Old Dominion* decision was rendered prior to *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938). It was distinguished in *McCandless* v. *Furlaud,* 296 U.S. 140 (1935), where the Court held that an equity receiver suing on behalf of creditors of a corporation could assert a claim against promoters. However, the Court did not state that the corporation itself or the receiver suing on behalf of the corporation could bring such an action.

Even if the federal common law were to the contrary, it would not avail Petitioner herein as he has commenced this action solely on the basis of the federal securities laws. Petitioner's common law rights as a New York State liquidator are determined by the law of the State of New York. Moreover, the causes of action set forth in the federal Bankruptcy Act in favor of a trustee in bankruptcy do not apply to Petitioner as his capacity does not derive from that statute.

pose of the federal securities laws. Those statutes were intended to govern the integrity of securities transactions and the securities markets; they were not intended to create a new federal law of debtor and creditor rights nor a new federal law encompassing the entire area of corporate mismanagement.

The purpose of Section 10(b) can again be illustrated by considering a sale of securities by an individual. When an individual knowingly engages in a security transaction, he cannot be defrauded in connection with that transaction in violation of the federal securities laws. Consequently, no action to review that transaction may be brought under the 1934 Act by him, by his successors in interest or by a creditor or any other non-participant in the transaction. The result should be the same when all of the shareholders of a corporation knowingly ratify and affirm the corporation's participation in a security transaction.

If the Court holds that a federal claim can be stated on behalf of a corporation notwithstanding ratification of the corporate security transaction by all shareholders, there will be no finality to any security transaction by a corporation or any entity other than an individual. Since interests in corporations and other entities are transferable, any successor holder of any such interest might complain of the validity of a transaction consummated while his predecessor held his interest. Certainly as regards corporate shareholders, such a result would be contrary to the federal policy set forth in Rule 23.1 of the Federal Rules of Civil Procedure.

If this Court permits Petitioner to sue on behalf of Manhattan whose securities transactions were authorized by its sole shareholder, it will overturn long standing principles of corporation law and will intrude on state regulation of corporate mismanagement and creditors' rights. Moreover, such a decision will bring into the federal courts new

actions based on theories not contemplated by Congress and extending far beyond the intended scope of the federal securities laws. Any such creation of new rights should be left to Congress and should not be undertaken by this Court in the unusual circumstances presented herein. Consequently, Petitioner should not be permitted to bring an action under the federal securities laws on behalf of Manhattan.

III.

PETITIONER HAS NO STANDING TO SUE ON BEHALF OF MANHATTAN'S CREDITORS UNDER THE FEDERAL SECURITIES LAWS FOR JUDICIAL REVIEW OF CORPORATE SECURITIES TRANSACTIONS.

Petitioner claims to be suing on behalf of Manhattan. However, as established in Point II, *supra*, Petitioner, suing on behalf of Manhattan as a corporate seller, cannot recover under the federal securities laws because defendant Begole, its sole shareholder, authorized and participated in the corporate securities transactions.

In apparent recognition that Petitioner is foreclosed from suing on behalf of Manhattan, the SEC suggests that Petitioner might have standing to maintain this action as the representative of injured creditors and policyholders of Manhattan (Amicus Brief, p. 27). In making this suggestion the SEC indicates an unfamiliarity with the record herein. First, the policyholders of Manhattan were reinsured at the time of the liquidation. Second, Petitioner does not claim any injury to any creditor of Manhattan. Third, Petitioner does not claim to be suing on behalf of Manhattan creditors.

Assuming, *arguendo*, that a creditor of Manhattan was injured, the SEC is mistaken in concluding that creditors of a corporation—in addition to its security holders—have

standing to sue under the securities acts with respect to security transactions of the debtor corporation. Contrary to the position taken by the SEC, there is nothing in the legislative history of the federal securities laws to support the proposition that creditors of a corporation have standing to sue under those statutes. Although the SEC asserts that Congress was concerned with the protection of corporate creditors and holders of insurance policies, reference to the legislative history of the 1934 Act makes it clear that such concern was directed toward conditions in the national securities and credit markets and to the functioning of the national securities exchanges. When read in context, the SEC's citations to the legislative history do not support its position. See S.Rep. No. 1455, 73rd Cong., 2d Sess. 5 (1934) and 78 Cong. Rec. 7867-7869 (1934).

Neither case cited by the SEC (Amicus Brief, p. 28) justifies extending to creditors standing to sue under the 1934 Act. In *Pepper* v. *Litton*, 308 U.S. 295 (1939), a bankruptcy case not involving the federal securities laws, the Court held that a trustee under the Bankruptcy Act could enforce for the benefit of creditors the fiduciary obligations of a director or dominant stockholder. *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961), was an action by a trustee in bankruptcy brought on behalf of a publicly-held corporation, and the trustee represented the corporation and its public shareholders as well as its creditors. There could be no claim that all of the shareholders therein had ratified the corporate securities transactions. As Judge Herlands indicated in distinguishing *Hooper*, the "scheme [in that case] indeed an unfair sale of securities and it had as a major purpose the spread of watered stock to many investors." (App., p. 87a)

In support of its position that creditors have standing to sue under the securities acts the SEC states that it

has long been recognized that controlling shareholders owe a duty to corporate creditors. No citation in support of this proposition is given, apparently because any such citation would have to be to state law which provides corporate creditors with ample remedies against dishonest officers, directors and shareholders.[8] The absence of effective state remedies for participants in the national securities markets necessitated the enactment of the federal securities laws; however, the existence of effective state remedies made it unnecessary for Congress to create new rights for creditors and make it unnecessary for this Court to create such remedies under Section 10(b). As the Court of Appeals below indicated:

> "(W)e do not decide that the creditors of Manhattan do not have any remedy under general state tort law for the fraud practiced on their debtor, but only that the federal Securities Acts have not provided a federal forum for its enforcement." App., p. 107a.

Although the SEC asserts[9] that this Court need not reach the question of the validity of the limitation established in *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2nd Cir.), *cert. denied*, 343 U.S. 956 (1952), that only a purchaser or seller of securities may maintain an action for damages under Section 10(b), it fails to recognize that the validity of the purchaser-seller doctrine must be reviewed by the Court if it considers the question of Petitioner's standing to sue on behalf of Manhattan's creditors. *Birnbaum* will be seriously eroded if Petitioner is permitted to maintain this action on behalf of creditors, who were neither pur-

8. *See e.g.*, New York Business Corporation Law, Sections 719 and 720; *New York Credit Men's Adjustment Bureau, Inc.* v. *Weiss*, 305 N.Y. 1, 110 N.E. 2d 397 (1953); and New York Debtor and Creditor Law, §§270-281.

9. The SEC concedes that the Court does not have to review the *Birnbaum* rule in determining Petitioner's standing to sue in connection with the sale of Manhattan's capital stock. Amicus Brief, p. 7, fn. 6.

chasers nor sellers of any of the securities involved in this action.

The *Birnbaum* holding has been uniformly and repeatedly followed by every Circuit considering the issue. See *Greenstein* v. *Paul*, 400 F.2d 580 (2d Cir. 1968); *Herpich* v. *Wallace*, 430 F.2d 792 (5th Cir. 1970); *Mader* v. *Armel*, 402 F.2d 158 (6th Cir. 1968), *cert. denied sub nom. Young* v. *Mader*, 394 U.S. 930 (1969); *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262 (7th Cir.), *cert. denied sub nom. Bard* v. *Dasho*, 389 U.S. 977 (1967); *The Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783 (8th Cir. 1967); and *Erling* v. *Powell*, 429 F.2d 795 (8th Cir. 1970).

In 1969, the Court of Appeals for the Second Circuit reviewed and reaffirmed the purchaser-seller requirement in *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970):

> "The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, the protection of defrauded purchasers and sellers. It is not the province of the courts to extend Section 10(b) to apply to transactions not intended to be covered by Congress. We do well to heed the words of Mr. Justice Black, writing for the Court in a case about another section of the 1934 Act, *Blau* v. *Lehman*, 368 U.S. 403, 413, 82 S. Ct. 451, 457, 7 L. Ed. 2d 403 (1962):
>
> > 'Congress can and might amend [the Act] if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.'" 417 F.2d at 969.

In the context of a judicially created cause of action, and in the absence of clear Congressional intent, a doctrine as

long established as *Birnbaum* should not be overruled in order to give creditors or their representatives standing to sue under Section 10(b).

The legislative history of the securities laws, the decisions rendered thereunder and the adequate remedies available to creditors under state law all support the proposition that a creditor who is not a security holder of his debtor should not have standing to obtain review of corporate securities transactions. Dramatic practical consequences would follow if this Court were to hold to the contrary. If Petitioner is permitted to maintain this action on behalf of creditors, then any creditor will have standing under the federal securities acts to object to any security transaction of its debtor. In the case of a corporate debtor, any creditor might challenge any decision of management to issue, purchase or sell any security. Even the most routine corporate transaction would be subject to the scrutiny of the federal courts at the request of a litigious creditor. Indeed, creditor actions might be brought notwithstanding the decisions or interests of the corporation's shareholders. Such a federal incursion upon state law governing the management of corporations and the relationship of creditor and debtor should not result in the absence of clear Congressional intent. It certainly should not arise from the judicial creation of a private remedy by inference from the very general anti-fraud provisions of Section 10(b).

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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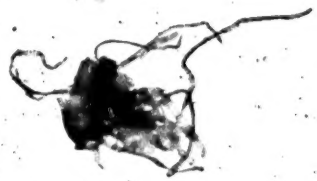
Dated: August 30, 1971



ATTACHMENT A

STATEMENT OF FACTS

The courts below considered the motions to dismiss the Complaint, the final resolution of which is now on review before this Court, not only on the basis of the allegations of the Complaint but also with regard to additional claims set forth by Petitioner in his briefs and in oral argument. In an attempt to give the Court as clear a picture as possible of what Petitioner has claimed throughout the course of this litigation, this "Statement of Facts" also refers to claims made by Petitioner which do not appear in the Complaint.[10] It should be understood that a reference in this brief to any assertion by Petitioner does not mean that the Respondent Irving admits that any such claim is true.

Petitioner alleges that as of the autumn of 1961, Manhattan was wholly-owned by defendant Bankers Life. (C. ¶17; App., p. 7a) At that time Bankers Life made two decisions which led to the events of this case. It released defendant Sweeny as President of Manhattan (CAB, p. 5), and it determined to sell its interest in that company. After his discharge, Sweeny introduced the defendants Bourne and Begole, prospective purchasers of Manhattan, to James W. Bourland, a Vice-President of Bankers Life charged with arranging the sale of Manhattan. (App., p. 52a) Although it is not alleged in the Complaint, Judge Herlands assumed that at this time Sweeny came to an agreement with Begole

10. For purposes of this Attachment, the following abbreviations are used in references to the Record: "C"—Complaint in this action; "DCB"—Petitioner's Brief to the District Court for the Southern District of New York; "CAB"—Petitioner's Brief to the Court of Appeals for the Second Circuit; "Pet."—the Petition for a Writ of Certiorari; "P.B."—Petitioner's Brief to this Court on the merits; and "St. C."—Complaint in Petitioner's action in the Supreme Court of New York County. For the full names of persons and entities referred to herein, see pp. 1 and 2, *supra*.

and Bourne that he would be reinstated as President of Manhattan when, and if, they acquired control of the company. (App., 52a; see CAB, p. 5) Negotiations which commenced in November of 1961 led to a contract for the purchase and sale of the Manhattan shares which was executed by Bankers Life and Begole on January 19, 1962. (C. ¶19, 20; A. p., p. 7a; DCB, p. 8) Begole agreed to deliver to Bankers Life, at a closing to be held on January 24, 1962, a bank check or certified check in the amount of $5,000,000. (C. ¶20; App., p. 7a) The Complaint does not charge any misrepresentation, deceit or non-disclosure in connection with this contract of purchase and sale.

Some time after January 19, 1962, but prior to the closing date, Bourne informed Begole that he would obtain financing for the stock acquisition. (C. ¶21; App., p. 8a) Bourne contacted defendant Garvin, a partner in the defendant brokerage firm Garvin, Bantel, and asked Garvin to arrange with a bank to issue a $5,000,000 certificate of deposit and to grant a loan in the same amount secured by that certificate. (C. ¶21, 22; App., p. 8a; see DCB, pp. 7-9) Acting upon Bourne's request, Garvin arranged for Belgian Trust to issue a $5,000,000 certificate of deposit in the name of Manhattan. (C. ¶23; App., p. 8a) Garvin also asked Belgian Banking to loan $5,000,000 to the defendant New England, a company controlled by Bourne, upon the security of the Belgian Trust certificate of deposit to be issued in the name of Manhattan. (C. ¶23; App., p. 8a) On January 23, 1962, in final preparation for the closing, Garvin asked Gunter, an Assistant Secretary of defendant Irving, to appear at his office the next morning with an Irving check for $5,000,000 payable to Bankers Life. Garvin informed Gunter that the check would be paid for by the delivery of securities from Chemical Bank New York Trust Company. (C. ¶24; App., p. 8a)

Events of January 24, 1962

On the morning of January 24, 1962, Bourne, Sweeny, Begole and Gunter assembled at Garvin's office. Begole then executed two notes totaling $5,250,000 payable to New England. At the same time, Begole assigned to New England the shares of the Manhattan capital stock that he was to receive from Bankers Life. (C ¶25; App., p. 8a)

Later that same morning, Sweeny, Begole, Garvin and Gunter went to the offices of Manhattan for the closing of the sale of the Manhattan stock. There, Gunter delivered a $5,000,000 Irving check to Leo Lehane, an Executive Vice-President of Bankers Life. (C. ¶26; App., p. 9a; Pet., p. 6; DCB, p. 9; CAB, p. 9) Although the Complaint does not so state, Judge Herlands assumed that Begole did obtain possession of the Manhattan stock. (App., p. 55a; see C. ¶28, 38; App., pp. 9a-10a, 12a)

Following the closing, Begole, the new sole shareholder of Manhattan, installed a new Board of Directors for the company. (CAB, p. 18) All previous officers resigned or were removed, and the new Board unanimously elected a new slate of officers which included Begole as Chairman of the Board and Sweeny as both President and Treasurer. (Bankers Life Exhibit 7-H; see CAB, p. 5; Pet., p. 8 and P.B., p. 7) The new Board then adopted resolutions (App., p. 122a; Bankers Life Exhibit 7-H) which authorized:

1. President to open bank accounts of his choosing, including accounts at Irving;

2. Appropriate officers to be signatories on such accounts;

3. President and Secretary to take all necessary acts to effectuate intent of the above resolutions;

4. Sale of Manhattan's portfolio of Treasury securities; and

5. Purchase of a $5,000,000 certificate of deposit from Belgian Trust.

All of the above resolutions were submitted to the Board by Begole, and, as no dissenting votes are indicated, must have been passed unanimously. (See App., p. 122a; Bankers Life Exhibit 7-H)

Subsequent to the Directors' meeting, United States government securities were delivered from Chemical Bank to Irving. (CAB, p. 26) The securities were sold by Garvin, Bantel for the account of Manhattan to Second District Securities Co., Inc. The securities were delivered to the purchaser, and Irving credited the $4,854,552.67 proceeds of sale to Manhattan's account at Irving. (C. ¶27; App., p. 9a) Irving also received a $150,000 check of Manhattan for deposit to Manhattan's account. (CAB, p. 27) The Manhattan account at Irving allegedly was not opened until the afternoon of January 24, 1962. (C. ¶30; DCB, p. 10; CAB, p. 10; Pet., p. 9; P.B., p. 8)

Also on January 24, 1962, at the request of Garvin, Gunter brought to the offices of Belgian Trust an Irving check payable to Belgian Trust in the amount of $5,000,000. Gunter gave this check to Sweeny who in turn delivered it to Belgian Trust on behalf of Manhattan. Pursuant to Garvin's prior discussion with the bank, Belgian Trust then issued a six month $5,000,000 certificate of deposit in the name of Manhattan and accepted the Irving check in payment for it. Both Sweeny, as President of Manhattan, and Manhattan's Assistant Treasurer endorsed the certificate of deposit to New England. Bourne, as President of New England, accepted the certificate of deposit from Sweeny, and, in turn, endorsed it to Belgian Banking. (C. ¶28; St. C. ¶27; App., pp. 9a, 129a-130a; DCB, pp. 9-10; CAB, p. 10; Pet., p. 8; P.B., pp. 7-8; Plaintiff's Exhibit 10-A)

Belgian Banking then extended two loans to New England aggregating $5,250,000. One loan was for $5,000,000, and as collateral for this loan Belgian Banking took possession of the Belgian Trust certificate of deposit which had

been endorsed by Manhattan and then by New England. The second loan was for $250,000, and as collateral Belgian Banking took possession of the outstanding Manhattan stock which had been assigned to New England by Begole. In payment of the first loan, Belgian Banking drew a $5,000,000 check payable to Irving for the account of New England and delivered it to Gunter. The $250,000 proceeds of the second loan were deposited by New England in an account at Belgian Trust and were distributed, in part, as follows: to Garvin, Bantel—$25,000; to Begole—$50,000; to Bourne—$50,000; and to Belgian Banking—$100,000. (C. ¶¶28, 29; App., pp. 9a-10a; DCB, p. 10; CAB, p. 10; Pet., pp. 8-9; P.B., pp. 7-8) These various payments aggregate $5,225,000, and neither the Complaint nor any of Petitioner's briefs contain any allegation as to the disposition of the final $25,000 of the Belgian Banking loans to New England.

Later Events of 1962

By January 29, 1962, Irving is alleged to have made certain misleading entries on its own books, and Garvin is accused of obtaining backdated letters signed by Bourne. (C.¶¶ 31, 32; App., p. 10a; DCB, p. 10; CAB, p. 10; Pet., p. 9; P.B., p. 8)

On July 24, 1962, the various six-month arrangements entered on January 24 expired. The Belgian Trust certificate of deposit matured; the loans by Belgian Banking to New England became payable; and the loans by New England to Begole were due. (DCB, p. 10; Pet. p. 9; P.B., p. 8; St.C. ¶31; App., p. 131a). The Complaint and Petitioner's briefs have alleged that the response of Begole, Bourne, Garvin, Bantel, Belgian Trust and Belgian Banking was to renew these arrangements. (C. ¶33; App., pp. 10a-11a; St.C. ¶31; App., p. 131a; Pet., p. 9; P.B., pp. 8-9) $74,383.56 interest on the Belgian Trust CD was credited

to Manhattan's account at Belgian Trust (See Plaintiff's Exhibit 179 and Exhibit D to Brief of Irving to Second Circuit), and the proceeds of that CD were used to purchase a new Belgian Trust $5,000,000 CD for Manhattan. (C. ¶33; App., p. 10a-11a; DCB, p. 10; CAB, pp. 10 and 46; Pet., p. 9; P.B., p. 9) This certificate was delivered to Sweeny and was kept in his own physical possession. (CAB, p. 46; Pet., p. 10; P.B., p. 9) Finally, the Belgian Banking loans to New England were extended to January 24, 1963, and New England's loans to Begole were continued to January 24, 1963. (C. ¶33; App., p. 10a-11a; CAB, p. 47; Pet., p. 9; P.B., pp. 8-9)

In August of 1962, Sweeny allegedly returned to Belgian Trust the CD he had been holding, and was issued a second CD also in the name of Manhattan. (Pet., p. 10; P.B., pp. 9-10) Sweeny endorsed this new negotiable certificate on behalf of Manhattan, and delivered it to Belgian Trust together with instructions to deposit its proceeds upon maturity in Manhattan's account at Belgian Trust. (C. ¶34; App., p. 11a) Sweeny delivered that CD on the assurance of a letter stating that it would be held in trust for Manhattan. (CAB, p. 47; Pet., p. 10; P.B., pp. 9-10) Belgian Trust allegedly had issued that letter because Belgian Banking had received a separate letter from Begole authorizing it to treat the new CD, once endorsed by Sweeny, as collateral for the Belgian Banking loans to New England. (Pet., p. 10; P.B., p. 10; St.C. ¶31; App., p. 131a)

At the same time Manhattan also transmitted a $500,000 First National Bank of Boston certificate of deposit to Belgian Trust. This CD was delivered pursuant to the same letter from Belgian Trust which stated that it would hold the certificates in trust. (C. ¶34; App., p. 11a; St. C. ¶69; App., p. 139a; Pet., p. 10; P.B., pp. 9-10)

Events of 1963

In January of 1963, Belgian Banking allegedly indicated that it would not renew its loans to New England which fell due on January 24, 1963. (C. ¶35; App., p. 11a; DCB, p. 11; CAB, p. 11) In response to this information, Bourne and Begole initiated another series of transactions. (App., p. 60a)

First Transaction of January, 1963

On January 21, 1963, Begole, at the request of Bourne and Garvin, instructed Irving to issue $5,500,000 in bearer certificates of deposit for the account of Manhattan and directed that they be delivered against payment to Garvin, Bantel. On January 22, 1963, Marine Midland Trust Company of New York loaned Garvin, Bantel $5,500,000 on the security of the Irving bearer CDs, and the proceeds of this loan were delivered to Irving in payment for those bearer CDs. (St. C. ¶34; App., p. 132a) The Irving certificates of deposit were delivered to Marine Midland and were held as collateral for the loan to Garvin, Bantel. (Pet., p. 12; P.B., p. 11) The effect of this transaction was to create a $5,500,000 Manhattan deposit on the books of Irving. However, the negotiable certificates of deposit underlying this deposit were pledged to Marine Midland as security for its loan to Garvin, Bantel, which loan had been used to effectuate payment for the certificates of deposit.

Second Transaction of January, 1963

On January 23, 1963, Sweeny, Begole, Garvin and an officer of Belgian American agreed that the proceeds of Manhattan's $5,000,000 Belgian Trust CD and $500,000 First National Bank of Boston CD would be used to repay the New England loans at Belgian Banking. (St. C. ¶35; App., 132a)

On January 25, 1963, Belgian Trust credited Manhattan's account with $5,590,977.62: $5,075,616.44 of which represented the principal of and interest on the $5,000,000 Belgian Trust certificate of deposit, and $515,361.18 of which represented the principal of and interest on the $500,000 First National Bank of Boston certificate. (C. ¶37; DCB, p. 11; CAB, p. 11) Then, Belgian Trust issued a $5,500,000 check payable to Irving and charged this check against Manhattan's account. (C. ¶37, DCB, p. 11; CAB, p. 11; Pet., p. 12; P.B., p. 11) Irving, at the direction of Garvin, Bantel, issued its check to Belgian Banking in the sum of $5,250,000. The $5,500,000 Belgian Trust check payable to Irving and the $5,250,000 Irving check payable to Belgian Banking were exchanged at Belgian American on January 25, 1963. Belgian Banking applied the Irving check in payment of its $5,250,000 loans to New England. (C. ¶37; App., p. 12a; St.C. ¶36; App., p. 132a) At the direction of Garvin, Bantel, Irving credited the $5,500,000 check payable to it to the account of Garvin, Bantel at Irving and debited its $5,250,000 check payable to Belgian Banking to the same account. (St.C. ¶36; App., p. 132a; Pet. p. 12; P.B., pp. 11-12)

Later, Garvin drew a check for $250,000 representing the difference between the credit and debit to the Garvin, Bantel account at Irving and sent it to the Belgian American Banks. There Begole and Sweeny opened a special suspense account to hide those funds. (CAB, p. 49) Although Petitioner fails to disclose the fact in the Complaint or any of his briefs, Belgian American delivered those funds to Petitioner after Manhattan had been placed in liquidation.

Final Transactions of 1963

The Complaint alleges that two additional transactions occurred before the alleged fraud was discovered. First, on April 18, 1963, Belgian Banking returned to Begole and

Sweeny the shares of Manhattan stock which it had received as collateral for its loans to New England. (C. ¶38; App., p. 12a) Secondly, for the purpose of concealing the reduction in Manhattan's assets, Irving allegedly certified to the New York State Insurance Department on May 15, 1963, that Manhattan had on deposit at Irving the sum of $5,500,000 as evidenced by certificates of deposit issued on January 21, 1963. The certification included a statement that the certificates of deposit were free of all liens, claims, or encumbrances and were not held as security for any loan. (C. ¶39; App., pp. 12a-13a)

On or about August 22, 1963, Marine Midland Trust Company applied the proceeds of the $5,500,000 Irving CDs, which had been issued on January 21, 1963, to the repayment of its $5,500,000 loan to Garvin, Bantel secured by those CDs. (St.C. ¶39; App., p. 133a)

Conclusion

The alleged consequence of these seemingly disparate transactions which occurred during an eighteen month period was that the purchase of Manhattan was financed by its own assets. Petitioner has suggested two alternative times at which Manhattan funds may have been misappropriated. Under Petitioner's first theory, Manhattan was injured on January 24, 1962, when $5,000,000 of $5,004,552.67 (consisting of $4,854,552.67 deposit of proceeds of securities plus $150,000 cash deposit) in the Manhattan account at Irving were diverted by Begole to pay for the check to Bankers Life used for the purchase of the Manhattan stock. This theory has the advantage of simplicity but is inconsistent with Petitioner's second theory and certain facts admitted by Petitioner.

Under Petitioner's second theory, Manhattan was injured on January 25, 1963, when $5,500,000 of funds in its account

at Belgian Trust were misappropriated; $5,250,000 of which was used to repay the Belgian Banking loans to New England and $250,000 of which was diverted by Begole and Sweeny. Under this theory, the $5,000,000 Irving check to Bankers Life was paid for by the $5,000,000 Belgian Banking check payable to Irving for the account of New England which represented the proceeds of the Belgian Banking loan to New England.

Also under this theory $5,000,000 of the funds in the Manhattan account at Irving on January 24, 1962 were used by Manhattan to purchase the $5,000,000 Belgian Trust certificate of deposit issued to Manhattan on that date. The proceeds of this certificate of deposit were used on July 24, 1962 to pay for a second six-month $5,000,000 Belgian Trust certificate of deposit. On the same day Manhattan's account at Belgian Trust was credited with $74,383.56 interest on the maturing certificate of deposit. In August of 1962, the Belgian Trust certificate of deposit which had been issued on July 24, 1962 was exchanged for a new negotiable Belgian Trust certificate of deposit in the same amount, and the new certificate of deposit was delivered to Belgian Trust together with a $500,000 certificate of deposit of the First National Bank of Boston also owned by Manhattan. Both certificates of deposit were delivered on the assurance of a letter from Belgian Trust stating that they would be held in trust for Manhattan and that the proceeds would be credited to Manhattan's account on maturity. Petitioner alleges that the $5,590,977.62 principal and interest of those two CDs were credited to a Manhattan account at Belgian Trust on January 25, 1963. He further claims that thereafter $5,250,000 of those funds were misappropriated to repay the Belgian Banking loans to New England thereby injuring Manhattan.